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SUPREME COURT, U. S.
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Supreme Court of the United States

OCTOBER TERM, 1947

No. 407

IN THE MATTER

OF

REALTY ASSOCIATES SECURITIES CORPORATION,
Debtor.

VANNECK REALTY CORPORATION,
Petitioner,

against

REALTY ASSOCIATES SECURITIES CORPORATION, Debtor, and CONSOLIDATED REALTY CORPORATION,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PERCIVAL E. JACKSON,
Attorney for Petitioner
Vanneck Realty Corporation.

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TO THE HON. FRED M. VINSON, CHIEF JUSTICE, AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petition of VANNECK REALTY CORPORATION (a bondholder of the debtor), prays that a Writ of Certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above case on the 23rd day of July, 1947 (R. 222), modifying an order of the District Court of the United States for the Eastern District of New York (R. 189-193).

Opinions Below

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 209-219) is not yet reported. The judgment below (Judge Clark dissenting) modified an order of the District Court, dated August 5, 1946 (R. 189-193). The opinion of the District Judge (R. 171-185), upon which the order was entered, is reported in 66 F. Supp. 416.

Jurisdiction

The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (c. 575, Section 1, 52 Stat. 854 [11 USCA 47 (c)]) and under Section 240(a) of the Judicial Code (c. 426, 48 Stat. 926 [28 USCA, Section 347]).

Statement of the Case

The debtor is a wholly-owned subsidiary of Consolidated Realty Corporation which, in turn, is a wholly-owned subsidiary of Reconstruction Finance Corporation. The business of the debtor is to buy, sell, administer and deal generally in mortgages and real estate securities and real property (R. 4). Substantially, its sole obligation was on its publicly-held bonds which bore interest at 5% payable on an "if-earned" basis, the unearned accumulations to be due and payable at maturity together with principal (R. 10).

The debtor filed its voluntary petition in Chapter X on September 28, 1943, three days prior to the maturity date of its obligation to bondholders in the sum of $6,997,046.43.

The debtor was solvent and continued so to the termination of the proceedings. At the time of the filing of the petition, its assets consisted of $1,261,000 in cash on hand

and in banks and "legal investments" of a market value of $1,760,069, or a total of cash or its equivalent in the sum of $3,021,069. In addition, it had bonds and mortgage certificates of a book value of $897,853.29; bonds and mortgages of a book value of $4,164,751.46, and real estate of a book value of $1,580,313.40. Its total assets, therefore, had a book value of $9,282,000, and were subsequently appraised at $8,548,000.

It is common ground that had the petition not been filed, the bondholders would have taken judgment, which would have borne interest at 6%, for the full amount of their acknowledged claim. The avowed purpose of the debtor was to prevent such a result and to this end it sought to obtain a stay (R. 7).

After eighteen months in the reorganization court, and under the continued protection of the stay, the debtor moved to dismiss the proceedings upon its offer to pay its debts in full as they might be determined by the Court.

Rulings of the Courts Below

The District Court held that, to obtain dismissal, the debtor should pay what it would have had to, had it not initially sought the protection of the reorganization court, i.e., the full amount of the claim of the bondholders, plus the rate of interest, 6%, that the bondholders' judgment would have carried had they not been stayed from obtaining it, from maturity to the date of payment.

The Court of Appeals for the Second Circuit reversed, Judge Clark dissenting, on the ground that the claim of the creditors should not be accorded the efficacy it would have had had they not been stayed from reducing it to judgment, the same efficacy it would have had as an allowed claim in straight bankruptcy, and held that, since the creditors' claim of $6,997,046.43 consisted of $5,710,400 face amount of the bonds, and $1,286,646.43 of accumulated accrued and unpaid interest, both of which became

due and payable on the maturity date, no interest was payable on the $1,286,646.43, and as to the $5,710,400, only 5% interest was payable according to the terms of the indenture, though the obligation was past due.

The petitioner has urged that the contract obligation required the payment of 6% interest after maturity. But development thereof, for the purposes of this petition, is unnecessary. For that issue is merged in the larger one, that these creditors should be accorded the rights they would have had, had they been permitted to go to judgment. If they are, the judgment rate of 6%, and not the contract rate, whatever that might be, would concededly apply.

Questions Presented

The facts in the present case and the rulings of the Courts below result in the following questions presented by this petition for certiorari:

(1) In a Chapter X proceeding, and as against a solvent debtor, has an allowed claim arising out of an indebtedness maturing at the time of the filing of the petition the same efficacy as an allowed claim in straight bankruptcy?

(2) In a Chapter X proceeding, as against a solvent debtor, is a creditor, on a claim maturing at the time of the filing of the petition, entitled to interest on his total claim, including that portion representing interest accumulated before the filing of the petition and due with and at the time of the principal amount of the obligation?

(3) In a Chapter X proceeding, as against a solvent debtor, on a claim maturing at the time of the filing of the petition, is a creditor entitled to the rate of interest accorded a similar claim in straight bankruptcy.

Reasons Relied On for Allowance of the Writ

The reasons relied on by petitioner for allowance of a Writ of Certiorari by this Court are:

(1) The decision of the Circuit Court of Appeals for the Second Circuit in a Chapter X proceeding that a creditor of a solvent debtor on a claim maturing at the time of the filing of the petition does not have the same rights on distribution as he would had the petition not been filed, is a decision of first impression and involves an important question of Federal law which has not been, but should be, settled by this Court.

(2) The decision below determines the rights of a creditor of a solvent debtor on an obligation maturing at the time of the filing of the petition as less than the rights of a similar creditor in a straight bankruptcy proceeding and therefore vitally affects creditors and stockholders alike in all important corporate reorganizations under the Act where a voluntary petition is filed on the ground that the debtor, though not insolvent, is unable to pay its debts as they mature.

ARGUMENT

In a Chapter X proceeding creditors of a solvent debtor on a claim maturing at the time of the filing of a petition are entitled to interest at the legal rate on the full amount of their claim.

The debtor was solvent and the claims of its creditors had matured at or about the time of the filing of the petition. The Court below, though conceding that were the present proceeding one in straight bankruptcy the creditors would be entitled to legal interest on the full amount of their allowed claims, nevertheless denied them

that right in the instant case. It held that an allowed claim in a Chapter X proceeding does not have the same efficacy as one in a straight bankruptcy for the reason that Chapter X contemplates reorganization and continued existence of the debtor, while straight bankruptcy does not.

We submit that an allowed claim must have and has the same efficacy in Chapter X as it does in straight bankruptcy, though in reorganization that efficacy may be subjected to countervailing equities non-existent in the standardized conditions with which straight bankruptcy proceedings ordinarily must cope.

> "The rule to be accepted * * * is that enforced by courts of equity which differs from the rule in bankruptcy chiefly in its greater flexibility, the rule in bankruptcy being framed in adaptation to standardized conditions and that in equity varying with the needs of the action, though remaining constant like the statute in the absence of deflecting forces. * * *
>
> "When all the facts are known, they may be found to offer no excuse for a departure from the rule in bankruptcy which, as indicated already, is generally, even if not always, the rule in equity as well."
>
> *Lowden* v. *Northwestern Nat'l Bank & T. Co.*, 298 U. S. 160, 164-166, 80 L. Ed. 1114, 1117.

Even in straight bankruptcy allowed claims are accorded different rights dependent upon the solvency or insolvency of the debtor at the time of the payment. Interest on the claim is not allowed in all instances. It is only paid where equitable considerations dictate that this should be done (*Coder* v. *Arts*, 213 U. S. 223, 245, 53 L. Ed. 772, 782; *Sexton* v. *Dreyfus*, 219 U. S. 339, 55 L. Ed. 244).

In Chapter X, the fact that the purpose of the proceeding is the continued existence of the debtor is an equitable factor not present in straight bankruptcy that

must be given consideration in determining whether there are such countervailing equities as require the denial of legal interest on the full claim. This purpose of Chapter X is sufficient to deny legal interest when the claim is not due. Since the purpose of Chapter X is the continued existence of the enterprise, the filing of the petition should not effect an acceleration of unmatured claims; the creditors' and the debtors' rights alike should continue as though no petition was filed. The contract rights of the parties should govern and the creditor should not be entitled to treat the filing of the petition as a breach maturing the claim and transforming it into a peremptory demand (see *Ecker* v. *Western Pacific R. R.*, 318 U. S. 448, 455, 87 L. Ed. 892).

But while the debtor obtains a moratorium from present payment of his obligations by the stay provisions of the order approving the petition, he should not receive absolution from ever paying. Unless equitable considerations require a different result, the debtor should pay his obligations to the same extent, no less and no more, than he would have, had the petition never been filed. Obviously, in the instant case, had the petition not been filed, the creditors would have taken judgment at once for their claim, $6,997,046.43, principal and accumulated accrued and unpaid interest maturing on October 1, 1943. On that judgment they would have been entitled to 6% interest from the date of payment (New York Civil Practice Act, Section 481; *Taylor* v. *Wing*, 84 N. Y. 471, 477). To pay them a like amount in this proceeding is to pay no more than they would have obtained in the ordinary course of the continued operation of the debtor had a petition not been filed. To pay them only upon the termination of the proceeding is to give effect to the moratorium provisions of the statute under which the debtor was protected from a disproportionate sacrifice had it been compelled to pay on the due date. To require such a payment is merely to deny to the debtor the right to employ the statute to reduce its obligations—a right which should

be denied unless there are countervailing equities that dictate a different result (cf. *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112, 115).

Where, as here, the debtor was solvent at the time of the filing of the petition, continued so throughout the proceedings, had liquid assets consisting of cash and "legals" far in excess of the accumulated interest about to become due, and the equivalent of almost one-third of its total indebtedness, it is obvious that the sole purpose of the petition was to protect the debtor's equity from the disproportionate sacrifice which would have resulted had the creditors been able to enforce their claim in full on the due date. Under such circumstances, obviously there are no countervailing equities which should afford the debtor the right to employ the statute to reduce its obligations. On the contrary, the equities of the situation require payment in full.

The Court below transmuted petitioner's contention, that the equities require payment in full, into an assertion that the petition was filed in bad faith. The Court concluded that the creditors were estopped from urging that the petition was filed in bad faith by reason of their long acquiescence in the pendency of the proceedings;*

* The Court below also observed that two creditors had moved to dismiss the petition for lack of good faith. The basis of the motion was that the debtor was insolvent and that a plan of reorganization was obviously impracticable, though it was alleged in the petition and apparent to everyone, other than the two moving creditors, that the debtor was solvent. The District Court, concluding the debtor was solvent, denied the motion, a result in which all other creditors, including this petitioner, concurred. In the course of its opinion, after denying the motion, the District Court said that it would be a disservice to creditors not to give them the protection and benefit of the reorganization statute. The Circuit Court, in its opinion, stresses this fact and emphasizes that no one appealed therefrom, but, obviously, since petitioner concurred in the result of the District Court that the debtor was solvent at the time of the filing of the petition, and that a plan of reorganization was practicable, it would not appeal from the order denying the motion to dismiss, nor does any appeal lie from the reasons assigned or the language employed in the Court's opinion (*Jones* v. *Futrall*, 75 Fed. [2d] 418, 420).

that, on the other hand, if the debtor, though solvent and substantially liquid, had a right to take advantage of the provisions of Chapter X, the bad faith argument was irrelevant and the result not inequitable.

There is nothing in Chapter X that impales the creditors on the horns of such a dilemma. We accept the conclusion that a debtor may file, though not insolvent, so long as payment on the due date will entail destruction of the enterprise and a disproportionate sacrifice on the part of the debtor (see *Continental Illinois Nat. B. & T. Co.* v. *Chicago R. I. & Pac. Ry. Co.*, 294 U. S. 648, 672, 79 L. Ed. 1110, 1126).

The issue is not as to the propriety of the proceedings, but whether the impact of a permissible petition and a resultant stay must be borne by the creditors (cf. *In re New York, New Haven & Hartford R. Co.*, 147 F. (2d) 40, 48).

Chapter X does not provide that the right of a debtor to file invokes an automatic suspension of interest on the creditors' claim, either in whole or in part. This Court has pointed out in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 91 L. Ed. 175, that whether the proceeding be in straight bankruptcy, in reorganization, or in equity receivership, the issue is not whether the proceeding was properly initiated, but whether, in a final distribution of the assets as between classes of creditors or between creditor and debtor, the equities require that interest should be allowed or denied on the claim in whole or in part. These equities deny payment of any interest when the debtor is insolvent (*Sexton* v. *Dreyfus*, 219 U. S. 339, 349, 55 L. Ed. 244). They require payment of interest on the claim when the estate is ample to pay all creditors including interest after the petition is filed (*American Iron & Steel Mfg. Co.* v. *Seaboard Air Line R. Co.*, 233 U. S. 261, 58 L. Ed. 949).

Such interest is payable to the date of payment on the full claim, both principal and accumulated interest, in receivership (*National Bank, etc., of N. Y.* v. *Mechanics*

National Bank, 94 U. S. 437, 24 L. Ed. 176) and in straight bankruptcy (*In re John Osborn's Sons & Co.*, 177 Fed. 184) on the theory that the allowed claim has the same efficacy, and should be accorded the same rights, as a judgment (*National Bank, etc., of N. Y.* v. *Mechanics National Bank*, supra).

In line with the views expressed by Judge Clark in his dissenting opinion below, and in accordance with the expression of this Court in the *Vanston* case, supra, in the instant situation the balance of equities between creditors and the debtor requires the declaration of a rule that where the debtor is solvent and the obligation has matured at or about the time of the filing of the petition, the debtor should not have the right to reduce his obligation and the creditors should be entitled to the same amount as they would have received had they been permitted to reduce their claim to judgment and that, therefore, the creditors in such a situation are entitled to receive the legal rate of interest to the date of payment on the full amount of their matured claim, principal and accumulated interest treated alike.

CONCLUSION

WHEREFORE, it is respectfully submitted that this petition for a Writ of Certiorari should be granted to review the judgment of the Court below.

Respectfully submitted,

PERCIVAL E. JACKSON,
Attorney for Petitioner
Vanneck Realty Corporation.

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No. 405

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Respondents.

No. 406

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ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

Legal Intelligencer, 1218 Chestnut St., Phila. 7, Pa.

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BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF PETITIONS

The respondent Consolidated Realty Corporation is a corporation all of whose stock is owned by the Reconstruction Finance Corporation. Consolidated Realty Corporation, in turn, owns all of the stock of the debtor, Realty Associates Securities Corporation. The Securities and Exchange Commission is a statutory party herein pursuant to Section 208 of the Bankruptcy Act, 11 U.S.C. § 608, and its position in the instant matter in support of the petitions for certiorari is contrary to that of the Reconstruction Finance Corporation. In view of the conflicting positions of these two governmental agencies, I am authorizing each to present a brief in its own name. *Cf. Consolidated Realty Corp.* v. *Meredith, et al.*, 323 U.S. 758 (1944).

PHILIP B. PERLMAN,
Solicitor General.

OPINIONS BELOW

The opinion of the District Court (R. 171) is reported at 66 F. Supp. 416. The opinion of the Circuit Court of Appeals (R. 209), modifying the order of the District Court, is reported at 163 F. 2d 387.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 23, 1947 (R. 222). The petitions for writs of certiorari were filed on October 20, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U.S.C. §347(a), and Section 24(c) of the Bankruptcy Act, as amended, 11 U.S.C. §47(c).

QUESTIONS PRESENTED

(1) Whether the substantive rights of creditors to accrue interest on their claims are less in a Chapter X reorganization than in straight bankruptcy?

(2) Whether creditors holding matured and undisputed claims against the debtor on the date of a voluntary Chapter X petition, which claims consist of unpaid principal and interest, and which were prevented from being reduced to judgment by the debtor's resort to Chapter X, are entitled as against a sole stockholder upon dismissal of the proceedings and the return of the properties to the solvent debtor (a) to interest on the entire amount of their claims, including that portion representing interest accrued prior to the filing of the petition, and (b) to accrue such interest as may be allowed at the rate applicable to judgments rather than the contract rate.

STATEMENT OF FACTS

The debtor, Realty Associates Securities Corporation, deals in mortgages and other real estate interests (R. 4-5) and the respondent, Consolidated Realty Corporation, is its sole stockholder (R. 7). The Chapter X petition was filed by the debtor on September 28, 1943 in contemplation of the imminent maturity of a large publicly held bond issue due three days later, October 1, 1943 (R. 6). This was the principal (and practically the sole) indebtedness of the debtor, and its petition alleged that while the value of its assets exceeded "total liabilities inclusive of its capital stock," a forced sale might bring in less than the true value of the assets to the detriment of the stockholder interests (R. 6).

The bonds were originally issued in three series of $5,000,000 each in 1925, 1927, and 1928, due 1937, 1939, and 1943, respectively (R. 5; 8), and bore unconditional rights to 6% interest semi-annually (R. 42; 52; 62). On July 10, 1933, when some $12,450,000 principal amount was still outstanding, the debtor filed a voluntary petition in bankruptcy (R. 5; 8). The bankruptcy proceeding was terminated the following year as the result of a composition effected by the debtor. The composition involved a 15% payment on account of the outstanding indebtedness, an

extension of the remaining debt (including all three bond issues) to October 1, 1943, and a reduction in the interest rate thereon from 6% unconditionally to 5% "if earned." (R. 78). An amended indenture, dated as of July 10, 1933, defined "earnings" for interest purposes to permit deductions of capital losses provided that such losses could not be used to reduce interest below 3% per annum (R. 78; 92). Unpaid portions of the 5% annual interest were made cumulative and payable out of future earnings, or unconditionally at maturity (R. 10; 92). As a result, instead of being wiped out by bankruptcy, the debtor obtained a ten year moratorium which included substantial alleviation of its interest obligation.

During the moratorium years which followed, the debtor paid approximately 3% per annum, and took advantage of the unique definition of earnings to defer the remainder, thus retaining for its own use money which otherwise would have been payable to the bondholders.[1] As the extended maturity date approached, the debtor found itself still owing $5,710,400 in unpaid principal (R. 6; 191) and $1,286,646.43 in unpaid interest (R. 5; 10; 191). According to the Chapter X petition, it then had assets with a book value of nearly $13,500,000 (App.[2] b4), including approximately $1,261,000 in cash. (App. b7) and $1,760,069 in readily marketable securities (App. b3). Despite the availability of liquid assets more than sufficient to satisfy all interest claims, no payment of these claims was proffered. Instead, the debtor first attempted, in July of 1943, to obtain another voluntary extension and composition of the indebtedness and, failing in this, resorted to Chapter X to stave off the enforcement remedies normally available to the bondholders.

---

[1] See Statement of Earnings for the Six Months Ending April 30, 1943 (R. 138), for an illustration of the deduction of capital losses.

[2] "App." refers to the Appendices to Petitioners' Brief in No. 405, Filed Pursuant to Stipulation Dated September 26, 1947.

The Chapter X proceeding lasted nearly 18 months and was dismissed on April 2, 1945 on the petition of the debtor and its sole stockholder, Consolidated Realty Corporation (R. 7, 25). By that time the debtor's business situation and the value of its assets had improved sufficiently to persuade the stockholder respondent to advance it the funds necessary to discharge the indebtedness. The petition for dismissal, however, denied any liability for interest beyond 5% on the unpaid principal to April 15, 1945, the date fixed for payment and settlement (R. 26; 172). The court's dismissal order, provided for payment of the undisputed claims for principal and interest, and for a reserve to be retained by the Chapter X trustees sufficient to pay any additional amounts which might be allowed (R. 26 *et seq.*). Jurisdiction was reserved to adjudicate, *inter alia*, the dispute as to the proper interest rate and base, the specific issues with respect thereto being:

(1) Whether interest is payable after the institution of the Chapter X proceedings on that portion of the bondholders' claims which represented unpaid interest accrued prior to that date; and

(2) Whether interest on the bonds, matured as of October 1, 1943, accrued during the Chapter X proceedings at the rate of 5%, as the debtor and its sole stockholder contend is provided by the indenture, or at 6%, the judgment rate which the bondholders contend should equitably be applied since they were prevented from obtaining judgment by the debtor's petition for reorganization.

The District Court held that the bondholders were entitled to 6% judgment interest on their entire claim including unpaid principal and interest accrued to the date of maturity and the filing of the Chapter X petition[3] (R.

[3] Throughout these proceedings the date of the Chapter X petition and the maturity date of the bonds have been treated essentially as one; for, as previously noted, the petition was

171-181; 191). On appeal by the debtor and its sole stockholder, a majority of the Circuit Court of Appeals (Judges Swan and Learned Hand), construed the indenture as providing for a 5% rate of interest on the unpaid principal of the bonds after maturity,[4] and held that interest was payable at that rate and only upon the portion of the bondholders' claim which represented unpaid principal (R. 217). The judgment of the District Court was modified accordingly (R. 218). Judge Clark, dissenting, expressed the view that equitable considerations required the allowance of the 6% judgment rate of interest on the bondholders' entire claim, including interest accrued prior to the abortive Chapter X proceeding (R. 218).[5] The instant petitions for certiorari followed.

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filed only three days earlier and admittedly in contemplation of the imminent maturity of the bonds.

[4] While we believe that the indenture, properly construed, does not contain any applicable post-maturity rate of interest on the bonds and that, therefore, they bear the legal rate of interest after maturity, we do not press at this time our disagreement with the decision of the court below on this point. This interpretative issue is of no significance if petitioners are correct in contending that interest should be allowed on their claims as if they had been reduced to judgment.

[5] The Indenture Trustee had also appealed from another portion of the District Court's order which applied an interim payment first towards reduction of the bondholders' original claim, rather than upon the interest which had accrued during the course of the Chapter X proceedings (R. 191; 197). The Circuit Court found that such application produced a difference in the amount to which the bondholders were entitled only if more than 5% interest were payable, and in view of its holding as to the proper interest rate and base, regarded this aspect of the appeal as academic. Accordingly, this portion of the District Court's order was affirmed (R. 218).

ARGUMENT

The petitions present questions of importance in the administration of Chapter X of the Bankruptcy Act which we believe should be decided by this Court. The rights of creditors holding matured and undisputed claims against a debtor to accrue interest on those claims from the date of the petition at the rate applicable to judgments where, but for the petition, they would be entitled to reduce those claims to judgment and receive interest thereon at the judgment rate, is a federal question which, in the context of a reorganization proceeding, has not been, but should in our opinion be, considered by this Court. Improved business conditions and appreciations in asset realization values during the past few years have provided surpluses after payment of the principal of creditors' claims in many estates being administered under Chapter X, with resultant conflict between creditors and stockholders as to the validity and extent of the interest claims payable out of such surpluses. Thus, the question here presented is of recurrent importance under present business conditions.[6] We believe it was erroneously decided by the majority of the court below. In our opinion, the decision below introduces novel distinctions between allowable claims in straight bankruptcy and in Chapter X reorganizations which are unwarranted by the provisions and underlying purposes of the Bankruptcy Act. The determination below also runs counter to well established equitable doctrines applicable in federal liquidation and reorganization proceedings.

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[6] For example, aspects of this problem have recently been presented in the following reorganizations in which the Commission is a party: *In re Childs Company*, 69 F. Supp. 856 (S.D.N.Y. 1946), and S.E.C. Corp. Reorg. Release No. 67, C.C.H. Bankruptcy Law Service, par. 55,734; *In re United States Realty & Improvement Co.*, S.D.N.Y., Bkcy. No. 83280, order approving plan dated May 14, 1946, par. 18; *In re Equitable Office Bldg. Corp.*, S.D.N.Y. Bkcy. No. 78476, order approving plan dated October 24, 1947, appeals pending in the court below.

1. As previously noted, the decision below introduces a distinction between the allowable claims of creditors in straight bankruptcy and in Chapter X reorganization which is wholly unwarranted by the statute. The court below expressly recognizes that "allowed claims in bankruptcy are of the same efficacy as judgments with respect to bearing interest, where the assets of the bankrupt are sufficient" (R. 214). It had expressly so held in *In re John Osborn's Sons & Co.*, 177 Fed. 184 (1910),[7] a straight bankruptcy case, relying upon the ruling of this Court in *National Bank of the Commonwealth of New York* v. *Mechanics National Bank*, 94 U.S. 437 (1876). The latter case involved the liquidation of a New York bank under the National Banking Act[8] and the depositors were held to be entitled to interest on demand deposits from the date of demand at the rate applicable to judgments in the State of New York. This Court then stated (94 U.S., at 439):

> "If these claims had been put in judgment * * * the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment, because they were proved to the satisfaction of the comptroller. After they were so proved, they were of the same efficacy as judgments, and occupied the same legal ground."

Insofar as the decision below treats the principal amount of the bonds as differing from the accrued interest as respects its status as an interest bearing claim, the decision is contrary to Section 63(a)(1) of the Act, 11 U.S.C.

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[7] Appellants in the court below attempted to distinguish the *Osborn* case because of the failure of the bankrupt in that case to make any contract for the payment of interest. The court below stated, however (R. 214): "Assuming without decision that the attempted distinction would be invalid in an ordinary bankruptcy, we are not convinced that the 'judgment theory' is applicable in a Chapter X reorganization. . . ."

[8] Recently, in *Vanston Bondholders' Protective Committee* v. *Green et al.*, 329 U.S. 156 at 165 (1946), in dealing with a specialized interest problem in a Chapter X proceeding, this Court referred to bank liquidation cases as involving analogous principles.

§ 103(a) (1), which is applicable to a Chapter X proceeding as well as an ordinary bankruptcy, and which provides that an allowable claim shall include a fixed liability of the debtor, together with any interest thereon which would have been recoverable at the date of the petition. Under this provision principal and interest accrued to the date of the petition are treated as part of the creditor's single claim against the estate, just as they would be treated as a single claim if reduced to judgment. Thus, in *Johnson* v. *Norris*, 190 Fed. 459 (1911), the Fifth Circuit Court of Appeals ruled that interest was payable on claims which, as filed, included interest accrued prior to the date of the bankruptcy petition, before any part of a surplus held by the trustee could be turned over to the bankrupt.[9] In the present case, at the date of the Chapter X petition the bondholders' claim against the debtor amounted to $6,997,046.43, of which $1,286,646.43 represented interest accrued and accumulated prior to the Chapter X proceedings. Contrary to the statute, the holding below denies the creditor the full right to treat the accrued interest as part of his claim for the purpose of an allowance of interest.

The majority of the Circuit Court of Appeals differentiated straight bankruptcy from reorganization, and decided that, in the latter proceeding, creditors possessing matured and undisputed claims which would have been reduced to judgment but for the Chapter X petition, were not entitled to have their claims for principal and accrued interest treated as if reduced to judgment because, in the majority's view, Chapter X contemplates a "moratorium" for the debtor precluding the recognition of those claims as "peremptory demands, like judgments, upon which dam-

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[9] In *Ohio Savings Bank & Trust Co.* v. *Willys Corp.*, 8 F. 2d 463 (1925), the court below, in an equity receivership proceeding, applied the same theory in allowing interest on creditors' claims, part of which had represented interest accrued prior to the institution of the proceedings.

ages in the form of interest for delay in payment" is payable (R. 214).[10]

The attempted differentiation is apparently predicated upon the assumption, a fallacious one as we show below, that the greater remedial restrictions imposed by Chapter X in the interest of facilitating reorganization, require a holding that the claims of creditors in Chapter X are less than in straight bankruptcy. On the contrary, Section 200 (11 U.S.C. §600) provides that the rights of creditors with respect to the property of the debtor shall be the same in Chapter X as in straight bankruptcy unless "inconsistent with the provisions of this chapter"; and there are no provisions which would indicate that the substantive claims of creditors are less in Chapter X than in straight bankruptcy. If anything, they may be greater: See *e.g.*, the broad definition of "claims" in Chapter X which is set forth in Section 106(1), 11 U.S.C. §506(1).[11] So far as we know, this purported distinction, which conflicts with basic provisions of the Bankruptcy Act and runs counter to its underlying policy, is made for the first time by the court below.

2. Apart from the express statutory mandate that the substantive rights of creditors in Chapter X shall conform

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[10] The decision below does not push the concept of moratorium to the point of disallowing as between creditors and the debtor any "damages in the form of interest," a result recognized to be contrary to settled authority. Instead, that portion of the claim which represents accrued interest, assumed to be a non-interest bearing claim under local law unless reduced to judgment, was continued as a non-interest bearing claim and the bondholders were allowed 5% interest on the unpaid principal, which the court below held to be the post-maturity interest rate provided by the indenture. See pages 12-17, *infra*, where we discuss the inequity of the concept of moratorium so applied.

[11] Section 106(1) provides that claims recognizable in Chapter X include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of the Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent."

to those in ordinary bankruptcy, there are other important reasons why the substantive scope of a creditor's claim should not depend on whether Chapter X or straight bankruptcy is invoked. Thus, we believe that the choice of proceedings should depend upon the prospects of realizing or preserving through reorganization, values for the totality of interests affected which might be lost in a straight bankruptcy proceeding. However, if the amount of the creditor's claim which will be recognized is less in a Chapter X proceeding than in ordinary bankruptcy, basically irrelevant considerations will be introduced which will tend to intensify conflicts of interest between different classes of security holders as respects the appropriate choice of proceeding. In a case, such as the instant one, involving a controversy between a single class of creditors and the stockholder interests, the decision below can only have the effect of stimulating creditor opposition to the reorganization process.

The decision below also creates certain other difficulties in the administration of the Bankruptcy Act. For example, Section 238(1), 11 U.S.C. § 638(1), provides that where a Chapter X proceeding is ultimately converted into a straight bankruptcy liquidation, the proceeding shall be conducted so far as possible in the same manner and with like effect as if an involuntary petition in bankruptcy had been filed at the date of the Chapter X petition and a decree of adjudication entered when the Chapter X petition was approved. It would seem to follow from the doctrine enunciated by the majority of the court below that although judgment interest would be denied during the Chapter X "moratorium", it would be required to be allowed retroactively to the date of the original reorganization petition in the event that the proceedings were transferred to straight bankruptcy. It hardly needs to be emphasized that a creditor's substantive rights should not be based upon such a contingency.

Again, the determination below would afford an inequitable advantage to certain creditors in a case where,

because of special circumstances unrelated to the propriety of preferential treatment of their claims, these creditors were permitted by the Chapter X court to pursue their claims to judgments after the filing of the petition.[12] In the event that there are assets available for the payment of interest on allowed claims, the ruling below would require that interest be payable on the newly acquired judgments at the judgment rate while other creditors are relegated to the contract rate, which may be considerably lower. A similar situation would be presented had the instant petition been filed after the maturity date of the bonds (instead of before) and had some of the bondholders succeeded in obtaining judgments on their claims prior to the petition. The inequality which would result were the "moratorium" concept of the court below applied in these situations obviously conflicts with the underlying statutory policy of equality of distribution.[13]

3. In developing its concept of a "moratorium" purpose of Chapter X the court below misconceived the purpose of the restraints which Chapter X imposes upon the entry of judgments and introduced an arbitrary rule in conflict with the flexible equitable considerations governing the allowance of interest claims which this Court so clearly enun-

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[12] The fact that a stay of lawsuits against the debtor rests in the discretion of the reorganization court and is not mandatory under the statute [see Sections 57d, 113, 116(4), 11 U.S.C. §§ 93a, 513, 516(4)] negates the "moratorium" concept of the court below as a statutory prohibition against judgments and their incidents after institution of reorganization proceedings, including the accrual of interest on claims as if they had been reduced to judgment.

[13] Section 63(a)(5) of the Act, 11 U.S.C. § 103(a)(5), for example, endeavors to preserve the statutory policy of equality of distribution among creditors by providing that where claims are permitted to be reduced to judgment after the filing of a petition, costs and interest accrued between the date of the petition and the entry of judgment shall not be allowed as part of the creditor's allowable claim; but this does not destroy its status as a judgment.

ciated in *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156 (1946).

The purpose of the customary stay of action which the reorganization court has discretion to grant is to avoid a race of the diligent to obtain preferential access to the assets, to insure equality of treatment among creditors, to prevent piecemeal executions, and to provide an orderly and equitable liquidation or reorganization. The normal procedural remedies are thus rendered unavailable, but the purpose of this restraint does not include denial of the substantive rights to which creditors would have been entitled absent the statutory proceedings. As the court below recognizes, at least as regards a straight bankruptcy proceeding, those substantive rights include judgment rights to interest where the entry of judgment has been precluded by the institution of proceedings under the Bankruptcy Act. The greater restrictions imposed by Chapter X upon the exercise of normal creditor remedies, we believe, do not warrant diminution of the allowable claims of creditors in a reorganization under that Chapter. On the contrary, those added restrictions and the slower process of realizing upon a claim in Chapter X make it all the more imperative that the substantive rights of creditors be fully protected in the reorganization process.

The reasoning of the majority below that Chapter X contemplates a "moratorium" which precludes alteration of the contractual relationship between the debtor and its creditors prior to the effective date of a plan overlooks the fact that the contract dealt with would be incomprehensible unless negotiated with reference to the creditor's expectations of obtaining judgment rights. The contract itself provided for a 10-year moratorium of limited scope, including a reduction in the contract rate of interest from 6% to 5% together with contingent provisions for deferring the interest claim to maturity. Regardless of the dispute as to whether the modified contract should be construed as continuing interest at 5% after maturity in the absence of

action by bondholders to enforce their claims, it is inconceivable that bondholders would have consented to the composition had they understood that the debtor could by institution of reorganization proceedings obtain a further moratorium in which the accumulated arrears of interest would be treated as a non-interest bearing claim and the return on principal would continue reduced below the judgment rate.

In denying interest on that part of the bondholders' claim which represented prior unpaid interest, the majority below relied largely upon a local New York policy against the compounding of interest, a policy which it conceded would be inapplicable if the claims were treated as if merged into judgment (R. 217).[14] The court below, however, refused to treat the indebtedness at the date of the petition as a single interest bearing claim. In our view, the holding below is contrary to the provisions of Section 63(a)(1) of the Bankruptcy Act, discussed *supra*, pp. 8-9, and, in addition, contravenes the equitable considerations which this Court, in the *Vanston* case, *supra*, held applicable as respects the allowance of interest in a Chapter X reorganization to the exclusion of any rules under state law.

In the *Vanston* case, which involved a Chapter X reorganization, this Court pointed out that "the touchstone of each decision on an allowance of interest in bankruptcy and receivership has been a balance of equities between creditor and creditor, or between the creditors and the debtor" (329 U.S., at 165). "Where an estate (is) ample to pay all creditors and pay interest even after the petition was filed," this Court observed, "equitable considerations (are) invoked to permit payment of this interest to * * * creditor(s) rather than to the debtor" (329 U.S., at 164). While the actual holding in the *Vanston* case was to deny interest on interest coupons which had matured after the institution of reorganization proceedings, and which were

[14] See also the New York cases cited *infra* n. 16, which treat allowed claims in local insolvency proceedings as if merged into judgments.

left unpaid in consequence of restraints imposed in the course of judicial administration, this interest denial was based solely upon a merging of the equities as between the classes of security holders affected. The estate was insolvent and the proceedings had extended over a period of sixteen years—from equity receivership, to Section 77B, and eventually into Chapter X. The accruals of interest on the overdue coupons were so large that they ate deeply into assets which otherwise would have been available to the junior creditors. To have allowed this additional interest on interest would have enriched the first mortgage bondholders at the expense of the junior creditors whose equity in the estate would have been seriously diminished by the protraction of the proceedings. In effect, allowance of the interest sought by the first mortgage bondholders would have placed upon the junior creditors the expense of a reorganization instituted for the benefit of all creditors.

A similar equitable approach was taken by the court below in the railroad reorganization case of *In re New York, New Haven & Hartford R.R.*, 147 F. 2d 40 (1945), *cert. denied*, 325 U.S. 884 (1945), in which a secured creditor had been enjoined from realizing on pledged collateral at a time when it had substantial market value. By the time the reorganization plan was approved the collateral had become worthless. Under these circumstances the court below held (147 F. 2d, at 48):

> "*The damage to the banks resulting from it (the injunction) ought not equitably to be saddled on them but on the parties for whose supposed benefit the restraint was imposed, and particularly is this true where the decline in the value of the collateral resulted from an act of the debtor itself.* In our opinion fair and equitable treatment requires that the damage caused the banks should be made good to them and that they should be classified as secured creditors to the extent to which they could have realized on their collateral had they not been restrained from selling . . ." (Italics supplied.)

Analogous principles have been applied in other federal liquidations and reorganizations,[15] and, although not controlling in these proceedings, the New York courts give effect to the same equitable considerations in insolvency proceedings.[16]

The instant controversy presents the converse of the *Vanston* case and involves considerations resembling those present in the *New York, New Haven & Hartford R.R.* case. We believe that the equitable doctrines there enunciated require denial of the windfall which the debtor's sole stockholder would reap if the bondholders' matured and undisputed claims were not treated as if merged into judgment. As the reorganization petition substantially admits, the proceedings were instituted for the purpose of safeguarding the stockholder's equity in the debtor's assets, and were dismissed only after the debtor's financial condition had improved sufficiently to warrant that stockholder in advancing funds to discharge the debt. In depriving the bondholders of all rights to interest on a substantial part of their claim which was reducible to judgment at the date of the petition, and in denying them the judgment rate of interest on the balance, a rate to which they would have

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[15] Thus, in *Bindseil* v. *Liberty Trust Co.*, 248 Fed. 112 (1917) in holding that rents and profits belonged ultimately to a mortgagee who was restrained by the bankruptcy court from collecting them pending bankruptcy, the Third Circuit Court of Appeals observed (248 Fed., at 115): "As we are dealing in this case with the equitable administration of bankrupt assets, where creditors' *legal rights are preserved but where their legal remedies are lost and equitable remedies are substituted, equity requires the new remedies to be as effective as the old in protecting and enforcing such rights.*" (Italics supplied.)

See also, *Associated Co.* v. *Greenhut*, 66 F. 2d 428 (C.C.A. 3, 1933), *cert. denied*, 290 U.S. 696 (1933); *In re Wakey*, 50 F. 2d 869 (C.C.A. 7, 1931); *Mortgage Loan Co.* v. *Livingston*, 45 F. 2d 28 (C.C.A. 8, 1930); *In re Torchia*, 188 Fed. 207, 208-209 (C.C.A. 3, 1911).

[16] See *e.g.*, *Dorland* v. *Fidelity Development Co.*, 104 Misc. 97, 99, 171 N.Y. Supp. 1000, 1001 (N.Y. Sup. Ct. 1918); *Skilton* v. *Cordington*, 185 N.Y. 80, 87, 77 N.E. 790, 792 (1906); *Hunting v. Blun*, 143 N.Y. 511, 38 N.E. 716 (1894); *Lang v. Lutz*, 180 N.Y. 254, 260, 73 N.E. 24, 26 (1905).

been entitled absent the abortive Chapter X proceeding, the holding below saddles the creditors with the burden of a reorganization instituted for the benefit of the debtor and its sole stockholder.

We note, in passing, the reliance placed by the majority below upon a number of cases in which the Interstate Commerce Commission and federal courts have approved plans of reorganization which contained provisions for the accrual of interest at the contract rate subsequent to the date of the reorganization petition. As the majority below concedes (R. 214-5), it does not appear that the question as to the proper rate of interest was ever raised or considered in those cases. The opinions and available financial manuals indicate that with one exception [17] those cases all involved claims whose normal maturity dates did not arrive until well after the petition for reorganization,[18] so that the equitable considerations for treating them as if reduced to judgment would appear to be lacking.[19] These cases, moreover, did not deny creditors the right to interest on a claim which was reducible to judgment at the date of the institution of Chapter X proceedings. In view of these circumstances, we do not believe that they are of any value as precedents in the instant controversy.

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[17] *In re Adolf Gobel, Inc.*, Bankruptcy No. 79,526, S.D. N.Y., plan approved June 1, 1944.

[18] Such were the facts in *Ecker* v. *Western Pacific R.R. Corp.*, 318 U.S. 448 (1943); *Brooks* v. *St. Louis-San Francisco Ry.*, 153 F. 2d 312 (C.C.A. 8, 1946), *cert. denied*, 328 U.S. 868 (1946); *Chicago, Rock Island & Pacific Railway Reorganization*, 254 I.C.C. 707 (1943); *In re McKesson & Robbins, Inc.*, 8 S.E.C. 853 (1941), cited by the court below.

[19] We do not urge that a claim which would normally mature after the Chapter X petition is entitled to judgment interest from the date of the petition. In our view, the contract interest governs to the date of normal maturity and, in the case of an undisputed claim, judgment interest thereafter. We do not argue for the allowance of judgment interest as of the date of an accelerated maturity caused by the institution of receivership or reorganization proceedings, since this acceleration may be regarded as a penalty which, under the *Vanston* case, should not be permitted to flow from the institution of such proceedings.

CONCLUSION

The petitions for certiorari should be granted.

Respectfully submitted,

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